



LOVE YOUR LETTER OF INTENT
Avoiding the Risks of
Using a Letter of Intent

Sarah Fox, 2014

Avoiding the Risks of Letters of Intent

Use this checklist to help you avoid the risks of letters of intent

Risk Checklist

Avoiding the Risk that Letter of Intent Unclear	Y/N	Comments
Is the identity of the partners clear?		<i>These are the 4 core items for a construction contract, whether a letter of intent or a longer contract. Often letters of intent provide more clarity on the details for the larger project and leave the initial works vague. This is not helpful and creates uncertainty, and scope for disputes.¹</i>
Is the basis of the contractor's entitlement to payment clear for initial works?		
Is the scope of the initial works clear?		
Is the time for starting and completing the initial works clear?		
Is the letter of intent complete and a workable contract in itself?		<i>It should not refer to other contract terms, incorporate a standard form or rely on implied terms²</i>
Is the letter of intent unconditional i.e. does not depend on information, documents or approvals?		<i>These conditions must be met or there may not be a contract</i>
Does the letter of intent make it clear that it does not accept the contractor's tender?		<i>By accepting that tender it is a contract for the whole project</i>
Can the letter be accepted by conduct?		<i>Conduct is normally sufficient unless the letter says only signing will do</i>
Do the partners understand their obligations relating to the initial works?		<i>A clear contract is easier to comply with. See below</i>
Avoiding the Risk that the Letter of Intent Rumbles On		
Does the letter of intent say what will happen if the project contract is not agreed?		<i>The letter could terminate automatically, on notice from one partner, or it may not say</i>
Is there an effective incentive to agree the project contract?		<i>Limits are not enough, it needs termination</i>
Are there processes in place to agree the project contract?		<i>See Guide on What (Not) To Do</i>
Are you aware how to act so you conduct does not change, extend or waive any limits in the letter?		<i>See Guide on What (Not) To Do</i>
Is the letter of intent difficult to extend?		<i>Even if you can extend the letter, you shouldn't</i>
Are the partners ready to commit to the whole project at this stage?		<i>The employer may not terminate and so it could continue indefinitely</i>
Avoiding Risk that the Letter of Intent Does not Meet Partner/Project Requirements		
Does the letter of intent meet your requirements quality, sustainability, design, stakeholders etc?		<i>If the letter does continue then key project objectives will only be met if included in the letter</i>
Is the letter compliant with relevant statutes?		<i>A letter of intent may not meet planning requirements</i>
Is there security for the contractor's obligations e.g. insurance, bonds/guarantee, warranties?		<i>If you are not happy with the lack of security, do not proceed</i>
Are there procedures in place to make it simple to replace the contractor?		<i>See STAR Checklist</i>
Does the letter of intent have the same limitation period as the proposed contract?		<i>If not, the project contract must be signed to provide longer protection</i>
Does the letter of intent include sufficient rights and remedies eg a to terminate, to delay damages?		<i>See STAR Checklist</i>
Have the risks related to the initial works been identified and managed?		<i>See STAR Checklist</i>

What Happens if You Fail to Understand the Letter of Intent?

If you do not understand your letter of intent then:

- 1) You and your partner may be working under different assumptions e.g. one partner may think it is working under a contract while the other is working under a gentleman's agreement pending the completion of negotiations;³
- 2) You may not know your obligations such as:
 - a. what works are to be carried out (and which are not)
 - b. how much the contractor is going to be paid;
- 3) You will not know which terms and conditions apply;⁴
- 4) The incentives to conclude a formal contract may be insufficient to distract you from the project and negotiations will stall;⁵
- 5) The limits in your letter of intent may be waived, inadvertently, by your conduct after the letter is sent;
- 6) The employer may think she is gaining a competitive advantage because the project is starting sooner, but this is an illusion;⁶
- 7) Your rights may go unexercised e.g. the right to terminate or suspend, the right to adjudicate disputes.

What Happens if You Fail to Sign the Project Contract?

What happens after the letter of intent is sent depends entirely on the actions of the partners and project team. However, if there is no project contract, the possibilities range from bad to disastrous!

The employer could terminate the letter of intent and throw the contractor off the project. The contractor will probably get paid – but there may be a dispute as to whether it is just for the works under the letter of intent or all the works carried out to the date of termination. There is often a gap between the work done and the work instructed which is tricky to resolve. After termination, the employer may have to re-tender the project. In any case, she will face significant delays in getting a new contractor on board, as well as having to deal with two contractor companies.

On the other hand, the project team could carry on regardless. If they do, the only document setting out what the partners' obligations is the letter of intent. The employer will be hoping that the letter of intent limits her liability. The contractor will be hoping it gets paid a reasonable sum for all work carried out. Remedies which would normally be included in the project contract will have been omitted from the letter of intent, leaving both partners worse off.

Whatever happens, any agreed aims for and methods for managing risk on the project are unlikely to have been included in the letter of intent, which means the project is less likely to be a success.

Author of the 500-Word Contract™

Sarah Fox is a construction contracts specialist, who has written, adapted and reviewed all manner of construction contracts from 5-page letters of intent to over 50,000-word multi-million pound construction contracts. What she thinks you need, particularly when time is tight, is a really simple contract... a 500-Word version.

Although her 500-Word construction contracts are quick to read, understand and agree, none cuts corners. The 500-Word Letter of Intent is a mini-contract which you cannot extend. It has everything your letter of intent needs, just in a more user-friendly package.

Sarah believes that project success in any industry is built on trust and that starts with a contract with no nasty surprises. Please get in touch if you too believe that you should be able to read, use and understand your contracts in an instant.

For access to Sarah's FREE 3-part video series on Making Letters of Intent Work for You, click [here](#).

Footnotes

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- ¹ Russell Bailey and Wayne Lord in their unpublished masters dissertation *Letters of Intent: Avoiding the old mistakes, again* (2013, Loughborough University) states "*Ensuring works included in the agreement are relatively simple in nature, easy to value through the process of reference to priced documents already in existence, easily distinguishable from other activities, i.e. they can be readily separated from other construction tasks without implying other work not listed in the scope has to be undertaken and can be brought to a stop with a logical cut-off and restart position is equally as critical as the legal agreement. The point is to avoid ambiguity with works as well as terms.*"
 - ² Bailey & Lord (2013): "*It is also critical to note that, not only must the wording of the agreement be definitive and clear, it must not make express provision for future agreement to occur in order for the formal building contract to be executed.*"
 - ³ According to *Walford v Miles* [1992] AC 128 negotiations should prevent a contract coming into being.
 - ⁴ E.g. *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG* [2010] UKSC 38.
 - ⁵ HHJ Coulson in *Cunningham v Collett and Farmers (A Firm) (TCC)* [2006] EWHC 1771 (TCC), paragraph 91: "there is a clear risk that agreement will not be possible on all the matters necessary to give rise to the full building contract and that, if there is no such agreement, no principal contract will ever be entered into. It seems to me that that is an inevitable risk of any letter of intent which creates respective rights and obligations, no matter how carefully it is drafted."
 - ⁶ For further review of letters of intent see CIOB paper No 91, 1998 "The Effects Of Letters Of Intent" by J B McGuinness.